

C L I F F O R D
C H A N C E



VAT ON
ELECTRONICALLY
SUPPLIED SERVICES IN
RUSSIA

VAT ON ELECTRONICALLY SUPPLIED SERVICES IN RUSSIA: STATUS AND PROSPECTS

For almost two years now Russia has been applying VAT to B2C electronically supplied services ("**e-services**") and employs an online system of VAT registration, reporting, and payment for suppliers or intermediaries that do not have a presence in Russia.

However, from 1 January 2019 the rules applicable to cross-border B2C supply will also be extended to all B2B supplies of e-services. This change represents a departure from the approach in the analogous EU VAT rules and is likely to affect many foreign companies that may have no idea that they currently supply e-services to Russia.

In this note we provide an overview of the existing Russian VAT regime for e-services and explore potential consequences of the pending changes.

1. OVERVIEW OF THE EXISTING VAT REGIME FOR E-SERVICES

1.1 Background

Like Russian VAT rules in general, which largely stem from the 6th VAT Directive, the Russian VAT regime for e-services is broadly similar to the EU VAT system for e-services.

Special VAT rules for "*electronically supplied services*" were introduced into the Tax Code of the Russian Federation (the "**Tax Code**") in 2016 with effect from 1 January 2017. These changes affected the place of supply rules for e-services by shifting the place of supply to the customer's location. As for B2C suppliers, an obligation was also introduced for foreign suppliers or intermediaries with no presence in Russia to register with the Russian tax authorities and collect, report, and pay VAT on e-services supplied to consumers (individuals who are not registered as private entrepreneurs in Russia).

1.2 E-services

Services are deemed to be supplied electronically when they are automatically supplied over an information and telecommunications network, including the Internet.

The list of e-services is set out in the Article 174.2(1) of the Tax Code and includes 14 items, such as provision of advertising services on the Internet, provision of access to e-books/other e-publications, information/educational materials, images, music with or without lyrics, audiovisual content and cloud services (for the full list, please see Schedule 1). While the list is exhaustive, the descriptions of the e-services are worded so broadly as to capture most services that can be provided electronically.

Certain services, however, are expressly excluded from the list of e-services. Specifically, these are supplies delivered to a customer offline, even if the order is made through the Internet, such as software or databases that are delivered on CDs, flash drives or other physical media; provision of consulting services by e-mail; and provision of access to the Internet.

In addition, a general exemption from VAT applies to the licensing of software and databases in Russia. This exemption should normally also apply to the relevant e-services, as has been confirmed by a number of clarifications issued by the Russian tax authorities. However, it is yet to be seen whether this approach by the tax authorities will withstand (in our view, it should) the forthcoming amendments, which are discussed further.

1.3 Customers

Similar to reverse charging of VAT by customers under B2B supplies of e-services in the EU, companies and registered entrepreneurs in Russia normally deal with all aspects of applicable Russian VAT. Russian buyers normally gross-up, make a withholding, and do their reporting without involving their foreign suppliers. Accordingly, in most cases the existing rules do not affect foreign suppliers of e-services in B2B arrangements. Foreign suppliers and intermediaries, however, are affected when a B2C supply of e-services takes place.

By operation of Russian law, a customer's location is presumed to be in Russia if any one of the following is true: (a) the customer's place of residence is in Russia; (b) the customer's account used to purchase e-services is with a Russian bank or a Russian electronic money operator; (c) the customer uses an IP address registered in Russia; or (d) the international country code of the customer's telephone number used to purchase e-services is assigned to Russia. As is evident from the above, the presumption used by the Tax Code potentially encompasses a wider range of situations than the similar general presumption under EU law, which requires at least two items of non-contradictory evidence for a supplier to make a conclusion as to the location of its customer.

1.4 Obligations of foreign suppliers and intermediaries

According to the existing VAT regime for e-services, a foreign B2C supplier with no presence in Russia which receives payment directly from a Russian customer is obliged to (i) register with the Russian tax authorities; (ii) pay Russian VAT at a rate of 15.25% (16.67% starting 1 January 2019), calculated on the amount of payment made by the customer; and (iii) file quarterly VAT returns.

Notwithstanding introduction of the VAT regime for e-services, the notion of registration for VAT purposes is still alien to Russian law and the registration for the purposes of VAT for e-services is of a general nature. By saying this we note that the Tax Code explicitly excludes the supply of e-services from the list of activities that may lead to the creation of a permanent establishment in Russia. Please, however, note that provision of e-services which involves processing of Russian individuals' personal information in some cases may trigger application of a so-called 'localisation' requirement under Russian personal data legislation. In brief, such requirement compels personal data operators (including e-services providers) to ensure presence of the databases in the territory of Russia. In practice, the process of localisation often may involve setting up physical presence of the operator's servers onshore, which may arguably give a rise to a risk of creating a permanent establishment in Russia.

When there is an intermediary involved in settlements, the obligations mentioned above in this section arise for that intermediary, not for the supplier. And in cases where there are several intermediaries, it is the one that receives payment directly from the Russian customer which must undergo tax registration. The manner in which Russian intermediaries pay VAT is similar to that for B2B supplies.¹ Participants in the Russian national payment system (such as banks and credit card issuers) and telecommunications operators are not considered to be Russian intermediaries.

According to clarifications of the Russian Ministry of Finance, a foreign supplier of e-services having a representative office in Russia, which is not involved in the provision of such services, should not be exempt from the requirement to register with the Russian tax authorities.

The Russian tax authorities have developed a special online service for foreign suppliers and intermediaries. The service is called "*VAT Office of an Internet Company*" and is available on the official website of the Federal Tax Service.² The list of foreign suppliers of B2C e-services, displaying their names, countries of tax residency and dates of registration, is publicly available and currently contains information on 192 companies, including Amazon, Alibaba, Apple, eBay, Bloomberg, Booking.com, LinkedIn, McAfee, Microsoft, Netflix, Uber and others.

2. CHANGES TO THE VAT REGIME FOR E-SERVICES

2.1 B2B becomes subject to the same regime as B2C

From 1 January 2019 all B2B supplies of e-services will become subject to the existing B2C VAT regime. It is therefore highly likely that the number of foreign companies that will be obliged to register with the Russian tax authorities and account for and pay VAT in Russia will significantly increase, as this will affect any B2B supplier of e-services that is currently enjoying its life while its Russian counterparty deals with all compliance, payment and reporting issues associated with Russian VAT.

Foreign suppliers of B2B e-services or respective foreign intermediaries will be required to register with the Russian tax authorities by 15 February 2019. We note that the new rules provide for no value thresholds or carve-outs for intra-group supplies of e-services. In addition, as mentioned above, the licensing of software or databases, while continuing to be exempt from Russian VAT, is likely to require formal registration with the Russian tax authorities.

It remains to be seen whether the Russian tax authorities will be successful in collecting VAT from suppliers of B2B e-services without the involvement of Russian tax agents. One may assume that Russian buyers will insist on their e-services suppliers registering with the tax authorities to enable those buyers to be eligible for input VAT recovery. However, in our view this assumption is only partially correct.

While large multinationals are likely to comply with the new regime for reputational reasons, small foreign enterprises may choose to continue not to charge any Russian VAT on their VAT supplies for the time being, if their buyers find it acceptable to forgo part of their input VAT or in cases where such buyers are themselves small enterprises and do not have any output VAT. According to the Russian Ministry of Finance, even paying VAT for foreign suppliers would not enable Russian business customers to recover input VAT.

¹ Although, the tax is calculated in a slightly different manner.

² Available at: <https://kioreg.nalog.ru/en>.

2.2 Practical implications of the new VAT regime for e-services

Apart from the requirement to register, foreign suppliers of e-services will need to have relevant internal processes in place to ensure proper reporting and payment of VAT.

Unlike Internet giants that dominate in the B2C market and became used to the existing VAT regime, administration and payment of VAT would not be an easy exercise for B2B suppliers, especially when intra-group services are supplied to a small number of Russian customers.

Also, it is often the case that e-services supplied between group companies are not separated from other services deemed to be supplied at the customer's location (such as consulting services) or other intra-group services that are sometimes supplied "in bulk".

The new rules will require thorough consideration of all intra-group services supplied, and determination of whether any e-services can be delineated. The e-services would then need to be separated on paper so that their value, as well as the amount of VAT, are clear from the agreement and/or invoice. Such isolation of the value of e-services will likely require additional efforts from a transfer pricing perspective in connection with determination of a new arm's-length value of the e-services.

All of the above will require joint efforts on the part of the foreign supplier and the Russian customer, as the latter will still have to act as a tax agent in respect of other types of services deemed to be supplied in Russia.

SCHEDULE 1

LIST OF E-SERVICES

According to Article 174.2(1) of the Tax Code, the following services qualify as "*electronically supplied services*" and therefore are subject to e-services VAT:

1. provision of rights to use computer software (including computer games) and databases via the Internet, including by providing remote access to them, and also updates to them and additional functionality;
2. provision of advertising services on the Internet, including with the use of computer software and databases functioning on the Internet, and provision of advertising space on the Internet;
3. provision of services associated with the placement of offers to purchase (sell) goods, work, services and property rights on the Internet;
4. provision of services associated with the granting of technical, organisational, informational and other possibilities via the Internet, where the services are made available by means of information technologies and systems allowing users to establish contacts and to conclude transactions between sellers and purchasers (including provision of an online trading platform operating on the Internet, where potential purchasers bid through an automated procedure and parties are notified of sale by an automatically generated notification);
5. establishing and/or maintaining a commercial or personal presence on the Internet, supporting e-resources of users (such as websites and/or webpages on the Internet), ensuring access to them for other network users, and providing users with the possibility of making modifications to them;
6. storage and processing of data, subject to the condition that the person providing such data has access to it via the Internet;
7. provision of computing power in real time for the placement of information in an information system;
8. provision of domain names and hosting services;
9. provision of services associated with administration of information systems and websites on the Internet;
10. provision of services rendered automatically via the Internet, where the purchaser of the service enters data, automated services on searching for data, its selection and sorting upon requests, provision of such data to users via information and telecommunications networks (specifically, real-time stock quotes, real-time automated translation);
11. provision of rights to use e-books (publications) and other e-publications, informational and educational materials, graphical images, musical works with or without lyrics, and audiovisual works via the Internet, including by granting remote access to them for viewing or listening to them via the Internet;

12. provision of services associated with searching for potential purchasers and/or informing clients about potential purchasers;
13. provision of access to search engines on the Internet; and
14. keeping statistical records on websites on the Internet.

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Moscow, Russia

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